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The Soviet Economic System  
Part I



General Calhoun, gentlemen of the Air Force Command and Staff College.

It is a pleasure to be at Maxwell Air Force Base and to have the opportunity to speak to you on the subject of, "The Soviet Economic System." When I received your kind invitation, I noticed that I was down for two lectures instead of the usual one on this subject. My immediate reaction was that such scheduling bore eloquent testimony to the fortitude and endurance of the officers of the United States Air Force. Two hours of Allen should be rewarded by the peacetime counterpart of the Purple Heart; perhaps a new decoration we can call the "Purple Ear."

With a topic as broad as the Soviet economy, it is difficult to know where to begin.

I propose to begin with a brief sketch of the Russian economy in 1913. This year is the base for many Soviet studies and claims. There is a great amount of misinformation about the size of the economy the Communists inherited from the Tsars.

On the one hand, the Soviets try to picture prerevolutionary Russia as the counterpart of Black Africa today. The official myth about the relative backwardness of Imperial Russia has been deliberately created so that Communist economic achievements since that time will appear to be even greater than they in fact have been.

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On the other hand, certain Western writers have, in my opinion, grossly overstated the output of Russian industry in 1913 in order to play down and pooh pooh its growth since the Communist takeover. The Soviet party line would have you believe that in 1913, Russian industrial output was less than 7 percent of that of the United States in the same year. In contrast, the work of Professor Mitter for the National Bureau of Economic Research, as I understand it, leads him to the conclusion that this figure should be 22 percent. In absolute size, then, we are confronted with a range of 300 percent in these estimates. To borrow a simile from the Canine world, we are told that, in the last years of the Tsars, Russian industry resembled either a toothless, underfed lap dog or else a full-grown German shepherd, fully able to remove your head in one easy bite.

Recently, the most respected economist in the Soviet Union, Academician Strumilin, published a pamphlet which, in effect demolished official Communist claims.<sup>1/</sup> He placed 1913 Russian output at 11-12 percent of that of the U.S. Having passed his 80th birthday, Strumilin undoubtedly felt he could write objectively and survive.

In November of last year, my boss, Mr. Allen Dulles, testified before the Congressional Joint Economic Committee on the subject of Soviet economic growth. He cited the Strumilin research as

<sup>1/</sup> Strumilin, On the Paths of Building Communism (Na putyakh postroeniia Kommunizma), Moscow 1959.

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evidence that the official Soviet index of industrial production was a gross distortion.

A few days later, Pravda in a critical review of the Dulles testimony admitted the validity of the Strumilin data, and said that Khrushchev himself had presented it in a speech in July. We have yet to see this July speech in the West. However, the official Soviet handbook, approved for publication in August, still carried the more exaggerated claims. Finally Khrushchev himself, in his September speech to the New York Economic Club included a statement based on the same data that Pravda chided Mr. Dulles for using.

At this point I thought we had them. I proposed to Mr. Dulles that he write a letter to the editor of Pravda, dropping a carbon to the New York Times, stating that as we understood the Pravda remarks, the Soviet government had decided to cut its claims for economic growth in half for the years 1913-58. But  
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Mr. Dulles said no.

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So much for what existed at the time of takeover. The first major problems that faced the revolutionists were political and military — to get Russia out of the war with Germany, to bring the internal civil war to a successful conclusion, and to resolve the battle for control within the Communist Party itself which followed the death of Lenin in 1924. By 1928, three important developments had taken place:

First, Stalin had emerged as the absolute victor in the internal power struggle.

Second, the economy had finally been restored to its pre-revolutionary level of output, and

Third, out of the murky dogma of Marxism and Leninism, the surviving Communist leadership had molded a program of economic action which remains in force today. The central theme of the program is forced draft industrialization. One of the best descriptions of Soviet economic policy

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The relative levels of industrial production in the two countries are not strikingly different than the ratios of gross national product. That is, Soviet industrial production is probably about 45 percent of our own.

However, the output of capital goods in the USSR is higher than this overall ratio. Indeed, Soviet production of certain basic materials and producer goods is already about equal to that of the United States. On the other hand, their output of consumer goods is far below corresponding U.S. levels. Let's look at some specific figures.

(Briefing Aid 2)

1. You can see that in 1958, Soviet output of coal exceeded ours by about 30 percent.

2. Their output of machine tools was almost  $4\frac{1}{2}$  times our own.

3. Soviet output of steel was about 70 percent of ours. However, the end use pattern of steel was far different in the two countries.

4. Moving over to the consumer goods side of the chart, you can see that Soviet output of automobiles, washing machines and refrigerators was only a small fraction of our own. This was what I had reference to when I said that the use patterns for steel were quite different in the two countries. The Soviets use most of their steel to produce capital goods and to expand their

basic materials industries. As this chart shows, we do not.

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I do not conclude from this that secret of Soviet success lies in greater productive efficiency. On the contrary, compared to the leading free enterprise economies of the West, productivity in the Soviet economy even today is relatively low.

Let me show you a few figures.

(Briefing Aid 3)

1. This chart first compares total population in the U.S. with that of the USSR. We have about 177 million people in our country compared to over 210 million in the present borders of the USSR.

2. Of this total, the Soviets have nearly 100 million in the civilian labor force. This is a high participation rate; somewhat over 47 percent. In contrast, only about 38 percent of our population, or 67 million, are in the labor force.

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3. As far as employment is concerned, the USSR still has the bulk of its labor force on the farms. And with almost 47 million people in agriculture, the Soviet Union produces somewhat less food than does the United States, which has only 7 million farm workers. It is not surprising that the USSR has sent several agricultural delegations to the United States as part of the East-West exchange program. They have also welcomed American farm experts to the Soviet Union, and are trying to find out how we do it.

4. Turning to industry, you can see that the USSR has nearly 4 million more persons in industry, or about 20 percent more than the United States. At the same time, the value of U.S. industrial output is more than twice that of the Soviet Union. This means that productivity in Soviet industry is less than 40 percent of that in the United States.

5. In contrast, we concentrate most of our labor force in the service industries - trade and government, most prominently.

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The very low level of productivity in agriculture and the relatively low productivity in industry exist despite massive efforts in education and particularly in technical training.



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First of all, the Communist Party is in complete charge of both policy formulation and execution. At the apex, the highest council is the Party Presidium. This body of 14 members is

presided over by Khrushchev, who is First Secretary. The military leaders, the secret police, and the professional industrial managers no longer have a direct voice in this council.

The Secretariat of the Presidium is the group responsible for day-to-day interpretation of policy. Of its ten current members, only one, Suslov, has a tenure longer than Khrushchev, and thus is the sole member who does not owe his present position to Mr. Khrushchev.

We are now ready to examine the economic chain of command.

(Briefing Aid 4)

1. At the top left, you can see the Presidium of the Party which we have already discussed.

2. In the center is the Presidium of the Council of Ministers, of which Khrushchev is also chairman. This is the top governmental body charged with the implementation of policy, that is, with carrying out decisions of the Party leadership. The two first deputies are Mikoyan and Kozlov. Kozlov is a former Leningrad party boss, who is now the designated "heir apparent." You may remember his visit to the United States last year.

3. The reorganization of industry and planning, carried out in the latter half of 1957, has greatly enhanced the role of Gosplan. Gosplan is not only responsible for developing short and long-term economic plans, but is also partially responsible for plan execution. Its chairman is Kosygin, who is also a deputy chairman of the Council of Ministers.

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4. There are a number of State Committees - for Automation and Machine Building, for Labor and Wages, and for Scientific and Technical matters. These committees clearly have important functions, but by their very nature are of lesser rank than Gosplan.

5. Returning to the center of the chart, the Council of Ministers is directly responsible to its Presidium. Several members of Gosplan are also members of the Council of Ministers. Also, the Council has a more political flavor than formerly because members of the 15 Union Republics sit on it.

6. The Union Republics have direct control of the regional councils of national economy in their respective territories. These councils of national economy, or *sovnarhozy*, are responsible for well over three-fourths of industrial output. Most of the remainder is under the control of local governments.

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The reorganization of 1957, then, substituted a pattern of territorial control over industrial plants. It replaced the previous pattern of direct control from the center by specialized industrial ministries. Each one of the republics and regional councils is under the direction of the Communist Party.

The major beneficiaries of the Party's reestablished dominance are the apparatchiki the people who run the party machinery. Khrushchev's personal attention to economic matters, his persistent demands that party people master a knowledge of economics, and

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the establishment of special courses for party workers, all reflect the increased role of the Party in the day-to-day operation of the economy.

This is a shift away from past control of industry by the technical-engineering elite -- the former industrial ministers. To date, the shift seems to have been a success. Industrial production maintained the same rate of growth in 1958 which is enjoyed under the old setup in 1957, and moved ahead even more rapidly in 1959.

To move on, I should like to review for you, in very brief fashion, the elements of the national economic plan. Actually, there are 13 interrelated sub-plans which make up the whole, and on our next chart the more important ones are highlighted.

(Briefing Aid 5)

1. Aggregate Indices of Activity. These are monetary estimates of such key elements as gross value of output for industry, agriculture, transport, the volume of retail and foreign trade, the value of capital investment, and so forth.
2. Production. This sub-plan consists of the output schedules for specific commodities in physical units in great detail and is the most important part of the over-all plan.
3. Material Technical Supply. Given the production goals, a schedule of allocations is drawn up designed to provide each producing unit with the amount of raw materials, semifinished goods, and capital equipment needed to meet its production goals. The material balance technique utilizes a series of technological

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coefficients, or input output ratios. Gosplan centrally administers the supply of over 1,000 commodities.

4. Capital Investment. The capital investment sub-plan has two primary functions. First, it provides the increased capital stock estimated to be necessary to meet future production goals. Second, it distributes investment resources in accordance with the priority preferences decided upon by the Soviet leaders.

5. Technology. The introduction of new technological processes has been a separate sub-plan since 1941. The need for industrial innovation has become much more important within the past year because of the need to increase labor productivity. The State Committee on Science and Technology has been retained as an independent body reporting directly to the Council of Ministers, one of two such committees which were retained in the reorganization of 1957.

6. Labor and Cadres. This part of the plan schedules increments to the non-agricultural labor force in accordance with over-all production goals and the planned average increase in output per worker. It also covers technical training plans.

7. Cost of Production (Sebestoimost). These are production cost estimates prepared for each commodity and essential service, which are combined to provide an estimate to total costs. Because of time limitations, I shall skip over the next three items as well as the final two, and turn to the

11. State Budget. The primary function of the state budget is

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to mobilize the financial resources of the economy and to direct their flow to accomplish the production objectives. The most important financial resource flows are, on the income side, the income from profits of enterprises and the turnover tax. On the expenditure side, the most important allocations are to investment and defense.

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As you have no doubt already concluded, the whole system is a statistician's idea of heaven. Dealing with all the paper work is undoubtedly more fun than working on the production line. Apparently many Russians think so too. Evidence of this are the constantly recurring drives to cut down on the size of the bureaucracy.

In practice, the national economic plan and its subcomponents is developed according to a system of rigid priorities. A limited number of industries has been consistently favored in the allocation of resources. These include the so-called "leading links" -- electric power, fuels, metallurgy, and the key engineering and defense industries. Once the output goals for these sectors have been decided upon, and the necessary inputs provided for, the bulk of available resources have been committed. Everyone becomes caught up in the tempo of plan fulfillment. Production is the great god -- it is more important than money, or people, or machines.

A logical consequence of setting highly ambitious production goals is that the Soviet economy is chronically short of everything. Machinery, transportation and people are worked at, or close to,

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maximum possible limits. To some Western observers, these outward manifestations are considered evidence that the economy is out of joint. They notice the uneven tempo of production, the use of very old equipment in industry, particularly in consumer goods factories, and the resort of some plant managers to extra-legal methods of operation.

But viewed through the eyes of the Russian leaders, the scene appears very different. They decided on the relative priorities to pull a backward nation up by its industrial bootstraps. They planned it that way. In large measure, they have achieved the results they were after.

To conclude the first part of our survey, I propose to discuss briefly the major shifts in Soviet economic policy since the death of Stalin.

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While these overly ambitious goals have not been met, agricultural output has moved up 50 percent in five years. The Soviet population as a whole is eating better today than ever before.

The immediate Soviet goal was to bring about a 10 percent increase in living space per capita by 1960, compared to 1954. The longer term plan is to put an end to the housing shortage in 10 to 12 years.

The housing situation remains extremely difficult, but the spectacular new construction has begun to have physical and morale effects. Even if still in one room, Russian urban families now have some hope. They often talk of an uncle, cousin or friend who has a modest apartment at last. Earlier this year, a Moscow taxi driver told a friend of mine,

"Ten years ago there was no hope. In 1954 there was a ten year waiting list. Now it is down to six years. I put my name down in 1956 when we were married, and I have every hope of an apartment by 1962."

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The Soviet leaders expect that labor productivity gains will result from better housing. This, they hope, will more than offset retarding effects of the diversion of investment funds away from building industrial plant to home construction. But there is a good deal of truth in Paul Henri Spaak's remark that it is more difficult to provide all members of the community with a roof, shoes, and meat than it is to launch an earth satellite.

Turning from the consumer welfare program, I would like to outline briefly the other major post-Stalin development, that is, the drive to improve technology.

The Soviet leaders renounced two points of doctrine to clear the way for a program of technical advancement. The first was that obsolescence was peculiar to capitalism and could not occur in a socialist economy. This doctrine had the effect of justifying the use of inefficient machinery until it was finally beyond repair.

The second point of doctrine was that Soviet excellence made a study of capitalist accomplishments unnecessary, and even unpatriotic. This policy, which was part of a broader campaign against "kowtowing to the West," had to be ridiculed and replaced by insistence on constant attention to the technical achievements of capitalism. As part of the program of borrowing technology from the West, the Soviets embarked on a broad exchange program -- visits by Soviet personnel to steel plants, electronics

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producing facilities and many others -- in exchange for reciprocal visits to the USSR. During 1959, about 1,000 Soviet representatives of industry and science visited the United States. Others toured modern production facilities in Western Europe.

As part of the same idea, the USSR began to step up its trade with the industrial West, particularly imports of machinery and equipment.

Let me show you some figures

(Briefing Aid 7)

1. You can see that Soviet imports from the industrial West rose from a low point in 1953 of about \$350 million to about \$780 million by 1957. Machinery and equipment imports accounted for between 35 and 40 percent of the total throughout this period.

2. The decline in 1958 was largely a reflection of lower levels of economic activity in the West, and hence in its ability to absorb raw material imports from the Soviet Union. This temporary downturn was probably reversed in 1959, although the figures are not yet available, for the Soviets were actively buying equipment and complete plants in Western Europe.

To summarize this somewhat rambling discourse, I think the following points are most important:

1. When the Communists took over, conditions in the Soviet Union were ripe for rapid economic development. The human and

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natural resources were at hand; there was no pressure of population against the resource base.

2. The economic program which the Communist leadership adopted was based on forced draft industrialization at all costs. The necessary correlary was that pre-revolutionary living standards were held constant, or even depressed, while every possible ruble was plowed back into investment in heavy industry.

3. Until the death of Stalin in 1953, the internal policy was one of "big stick" and "little carrot." He maintained this policy for 30 years as the undisputed ruler of the Soviet Union.

4. This course of action has brought the USSR to a position of the second largest industrial economy in the world, able to support a military expenditure program now equal to that of the United States.

5. While Khrushchev has moderated Stalin's repressive policies toward the Soviet consumer, the basic goals of the USSR remain unchanged. Forced draft industrialization and military power remain two cardinal points of Soviet policy.

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